



THE CITY OF SAN DIEGO
MANAGER'S REPORT

DATE ISSUED: March 2, 2005 REPORT NO. 05-060

ATTENTION: Land Use and Housing Committee and Housing Commission
Agenda of March 9, 2005

SUBJECT: Workshop on Residential Condominium Conversion Regulations
(SD Municipal Code Section 144.0501-144.0504)

SUMMARY:

THIS IS AN INFORMATION ITEM ONLY. NO ACTION IS REQUIRED ON THE PART OF THE COMMITTEE OR THE PLANNING COMMISSION.

BACKGROUND – During the past five years there has been a rapid increase in applications for condominium conversions. Between 1989 and 1998 no applications to convert existing rental units to condominiums were submitted in San Diego. From 1999 to January 2004, applications for condominium maps to convert 2,275 rental units were submitted (see Attachment 1). Since February 2004, applications to convert an additional 6,364 units have been submitted (see Attachment 2). In addition, many other apartment projects, which previously obtained condominium maps, have also converted or begun the conversion process. These, which are sometimes referred to as “off-the-shelf” conversions, do not require any approvals from the City prior to conversion although they are required to meet state noticing requirements. There is no reliable information on how many “off the shelf” conversions have taken place.

Typically, smaller, older apartment complexes in older portions of the City are required to obtain condominium maps from the City. Many of the larger more recently built residential complexes in newer areas of the City, such as Mission Valley and University City, obtained condominium maps at the time of construction and do not require further approvals from the City. Some, but not all, of these “off-the-shelf” projects have requested Certificates of Compliance from the City to provide assurance that they have previously received a condominium map. Properties containing approximately 2,600 units have received these certificates.

In June 2003, the Affordable Housing Task Force (AHTF) identified condominium conversions as a key affordable housing issue. The AHTF raised concerns that conversions were increasing the supply of relatively affordable homes for sale but reducing the supply of affordable rental housing. Therefore, they suggested that Council consider the following:

- Provide relocation assistance to renters displaced by conversion;
- Apply the City's Inclusionary Housing requirement to conversions; and
- Consider applying additional or stricter building standards for conversions.

In March 2004, the City Council amended the Municipal Code to include the following new regulations for condominium conversions.

- In years when the rental vacancy rate is determined to be less than seven percent, renters displaced by condominium conversions who earn less than 100 percent of the Area Median Income (AMI) receive three months current rent to cover relocation costs or down payment assistance;
- The City's Inclusionary Housing requirements were applied to condominium conversions. This allows provision of affordable units on-site or payment of an in-lieu fee; and
- No revisions to required building standards were adopted for condominium conversions because the Council indicated that the state building code standards were adequate. They did not select to apply building code standards to units being converted from rental property to condominiums that are different from the standards applied to the sale of existing "for-sale" or rental units.

DISCUSSION

During the past year, the rate of condominium conversions has continued to accelerate. Recent Planning Commission agendas have been dominated by requests for conversions. Advocates for affordable housing and Planning Commissioners have voiced concern that the pace of conversions was becoming too rapid, with potentially serious negative impacts on the rental stock and lower- and moderate-income renters. The Planning Commission and Land Use and Housing Committee requested a workshop to discuss additional steps, beyond those taken by Council in March 2004, which might be considered to address the rapid acceleration of condominium conversions. The Planning Commission also requested that answers be provided to a series of questions regarding condominium conversions. Staff responses to these questions are provided below, followed by a series of options for additional actions that could be considered to regulate conversions.

PLANNING COMMISSION QUESTIONS

Discuss the housing market today including quantification of the problem and how all income levels are being addressed.

The overall housing market in San Diego is notable for extremely high prices relative to incomes

in the region. The median price for all homes in the County in late 2004 (including condominiums) was \$478,000 and for single-family homes was approaching \$600,000. Recently, San Diego was identified as among the most unaffordable large metropolitan housing market in the United States with only about ten percent of residents being able to afford a median-priced home. From 2001-2004, housing prices rose much more quickly in San Diego than did rents. Prices have been rising at a rate of 15-21 percent a year while rents rose at only about five to six percent a year in 2002 and 2003. The San Diego County Apartment Association's (SDCAA) latest survey shows that rents rose by only one percent in 2004. The different rate of for-sale price and rental appreciation over a prolonged period is the chief reason that converting housing units from rental to for-sale status has become increasingly profitable and popular.

The rental vacancy rate has fluctuated between three and four percent during the past two years. This is a historically low vacancy rate indicating that supply is failing to adequately meet demand. The median monthly rent in San Diego in the fall of 2004 was \$996.50, according to the SDCAA.

Permits for 6,000-7,000 housing units were issued in San Diego annually from 2000-2003, but only approximately 4,500 permits were issued in 2004. Since 2000 about 60-65 percent of new housing units have been multifamily units.

The upper end of the housing market dominates new housing construction. Tax credits and other subsidies are allowing construction of a very small portion of the housing demanded by low-and very-low income residents. The moderate and middle-income segments of the market are not being supplied by new housing being built in this area. In other parts of the United States, the private sector continues to provide new housing for these sectors of the population without subsidies. Due primarily to high land costs stemming from San Diego's uniquely constrained physical location, the housing market in San Diego has become very different from most of the country and no longer allows average income families to be able to purchase a home.

1. What is the effect of conversions on the rental stock and rental affordability? How much has the rental stock declined?

One effect of conversions is to reduce the rental stock to some extent. However, determining how much the rental stock has declined is difficult for several reasons. Many newly converted condominiums return to the rental market immediately after purchase or at some later date months or years after conversion has occurred. Since the largest number of conversion applications has occurred only in the past year, it is unknown how many conversions will actually take place and how much impact on the rental stock there will ultimately be.

The 2000 census identified 227,000 rental units in San Diego including single and multifamily homes. Condominium map applications for over 8,600 units and Certificates of Compliance requested for 2,600 units indicate that at least five percent of the total rental housing stock could be impacted by condominium conversions over the next few years.

Recently, there has been very little affordable rental housing built in San Diego. Although there is little empirical data, it is likely that the large number of conversions now taking place will reduce

the affordability of the remaining rental stock. If there is less rental supply, there will likely be more upward pressure on prices. In addition, many other factors impact rental housing prices including the status of the for-sale market, interest rates, condition of the job market, fluctuations in demand by military families, the amount of doubling-up that occurs, and the amount of construction in San Diego and surrounding communities. It is difficult to identify precisely how much each of these factors is influencing rental affordability at a given point in time.

It is not possible to determine exactly how much condominium conversions are contributing to the low-vacancy rate and rental rates now existing in San Diego. Rents for condominiums that have been converted tend to be higher than prior to conversion because most properties are upgraded during conversion and because individuals who rent their units need the rent to cover mortgage costs and condominium association fees.

2. What is the current status of the rental stock? How many new rentals are being built, where are they located and what segment of the market are they being built for?

During the mid and late 1990s, due to the threat of condominium defect litigation, very few for-sale multifamily units were built in San Diego. Most new multifamily units were initially operated as high-end rental apartments although many were mapped as condominiums. The owners anticipated that when market conditions became more favorable and the threat of defect litigation decreased, they could be converted. This situation has changed dramatically in the past three or four years. Due to wrap insurance and changes in state condominium defect laws, large builders have re-entered the condominium market. Now, very few rental units are being built.

The exact number of rental units built during the past few years is difficult to determine because building permit data does not reveal whether permits are for-sale or rental units. In addition, many projects that were initially conceived as rentals have recently converted to condominiums during construction or shortly after completion. Also, many of the units sold as condominiums eventually returned to the rental market. The few new rentals being built today are primarily either luxury units for the upper end of the rental market or heavily subsidized units for the lower end of the market. Since 2000, the communities where the most new market rate rental units have been built are Centre City, University City and Mission Valley. Subsidized units are more widely dispersed with particular concentrations in Mid-City and the North City area where approximately 1,000 required “inclusionary” units have been built.

3. How does the recent increase in condominium conversions impact the ability to implement the City of Villages program? Should some multifamily sites be redeveloped rather than retaining and converting existing buildings?

Condominium conversions have not directly impacted the ability to implement the City of Villages program because the great majority of condominium conversions are occurring in locations outside the village areas identified in the City of Villages Opportunity Areas map. Many of the conversions taking place now in older communities are in locations where down-zoning took place after the existing units were built. On some sites, fewer units could be built in the future than what exists on these sites currently. Therefore, there is little economic incentive to demolish and replace the existing structures. Instead there is an economic incentive to upgrade and

increase the value of the existing structure either by renovating and increasing rents or renovating and converting to condominiums. Recent applications for condominium maps have been spread very widely throughout the older communities of the City.

With the shortage of housing in San Diego, it would be beneficial to build at higher densities along transit corridors and in village opportunity locations. However, in most of the locations where conversions are proposed, a plan amendment and rezone would be required to allow denser development.

4. What actions are other jurisdictions taking to address the increase in condominium conversions?

During the last major wave of condominium conversions in the 1980s many cities enacted regulations for condominium conversions. This included San Diego. Some of the regulations have lapsed while others are still in effect. There are great variations from community to community. Some cities require adherence to fairly strict development code and parking requirements for conversions. Others have limitations on the number of units that can be converted per year. In general it can be said that many communities take a more restrictive stance toward allowing conversions than San Diego although San Diego has a more generous relocation payment requirement than many other cities. Attachment 3 is a table comparing the key condominium conversion regulations of eight California cities.

5. Should a moratorium on conversions be considered until the full impact of this phenomenon is more fully understood?

This report provides a menu of alternative options for approaching the condominium conversion issue including a temporary moratorium. An analysis of each option is provided.

6. Discuss the noticing procedures and process.

California State Law and the City's Municipal Code require that all tenants living within a proposed condominium conversion project, and all persons applying for a rental unit within such a project, must receive adequate notice (see California Government Code Section 66427.1 and San Diego Municipal Code Sections 125.0431 and 125.0640).

Applicants for a condominium conversion project are responsible for providing the following notices to all tenants (including persons applying for rental units) within the proposed condominium conversion project. The applicant must submit certification for any of these noticing requirements that have been satisfied prior to the Public Hearing.

- 60-Day Notice of Intent to Convert to Condominium
- 180-Day Notice prior to Termination of Tenancy
- Copy of Staff Report
- 10-Day Notice of Approval of Final Map
- 10-Day Notice of Application for Public Report

- Notice of 90-Day Right to Purchase
- 90-Day Notice of Intent to Sell
- Summary of Tenant Benefits
- Eviction Notice

The City of San Diego is also responsible for providing public notices regarding the Tentative Map and Map Waiver Process. These notices are sent to all tenants within the proposed Condominium Conversion, as well as all addresses and owners within 300 feet of the proposed condominium conversion. Notices are also sent to the Community Planning Group and any persons who have submitted a request for notification. In addition, these public notices are posted on the subject property, on the City of San Diego's website, and are published in the local newspaper. The two types of public notices provided by the City include:

- Notice of Application
- Notice of Public Hearing

Attachment 4 provides a process flow chart that identifies when each notice is required on a typical condominium conversion and Attachment 5 is a table listing a detailed description of the notices, responsibility for providing them and legal basis for each.

7. Describe and discuss the tenant relocation payment program and process. Are many tenants moving out prematurely in response to notices and losing eligibility for relocation payments?

Currently, tenants who earn less than the Area Median Income (AMI) (\$63,400 for a family of four) receive relocation benefits equal to three months rent. This applies to all conversions deemed complete after February 2004 when this requirement was enacted. The Housing Commission administers this program and has a database (as of February 16, 2005) of 223 projects with 5,657 units.

Of these, only 27 projects with 118 units have completed the relocation payment process and another seven projects with 393 units are in the process of being reviewed for tenant relocation eligibility.

Payment of relocation benefits are a condition of final map approval. Benefits must be paid no later than the day on which a 60-day Notice to Vacate is issued to tenants. The Housing Commission requires the applicant to provide a tenant roster in advance of the issuance of the 60-day notice so that staff can determine and notify the applicant regarding which tenants are eligible for relocation payments. Several condominium conversion applicants have waived the income determination and are paying all tenants relocation benefits regardless of their income eligibility.

The Housing Commission has partnered with Community Housing Works, a local counseling agency approved by the U.S. Department of Housing and Urban Development to provide homeownership workshops for tenants living in apartments that will be converted to

condominiums. On-site workshops will be scheduled for projects with 50 or more units. Attendance at the workshops has been minimal to date.

8. How is the inclusionary money collected from condominium conversions being used?

Since inclusionary fees are not required to be paid until final map recordation, to date the City has only received \$27,000 in Inclusionary In-Lieu fees from three condominium conversion projects.

The inclusionary money being collected from condominium conversions and from new construction during the first year of the program was approved by City Council to be used for first-time homebuyer assistance. In May 2004, the Council approved two first-time homebuyer programs for eligible tenants of units undergoing conversion who want to purchase their unit. \$1,000,000 in HOME funds for tenants earning less than 80 percent of AMI and \$890,000 in Inclusionary In-Lieu funds for tenants earning less than 100 percent of AMI were set aside. No loans have yet been made under these two programs.

Additional Issues

The Housing Commission has found that administering the relocation program has been very difficult. It is expensive and time consuming to ascertain the incomes of all the tenants displaced by condominium conversions to determine which are eligible for relocation payments. Tenants who earn just over the Area Median Income challenge why they do not receive relocation payments while their neighbors, who earn slightly less, receive a payment equivalent to three months rent. Some applicants for conversion are providing relocation payments to all displaced tenants to reduce the administrative difficulties and tenant dissatisfaction and tension.

Tenants of projects undergoing “off-the-shelf” conversions have complained that they do not qualify for relocation payments regardless of their income. In addition, many tenants have complained about the noticing requirements and lack of clarity early in the process regarding when they will be required to relocate, what compensation, if any, they will receive, and what the process will be. The alternatives section of this report includes options to address some of these issues as well as the issues identified by the Planning Commission.

ALTERNATIVES

Additional actions and options for consideration to address Condominium Conversions

The options for regulations or actions that the City could take to address condominium conversions, are organized into the following five basic categories:

- 1. Maintain Current Policies**
- 2. Limit Conversions**
- 3. Increase Regulatory Requirements**
- 4. Increase Ownership and Affordability Requirements**

5. Expand Tenants Rights

The Council could adopt one or several of these options and all could be combined in a variety of ways.

1. Maintain Current Policies

Maintain existing policies of no numerical limit on conversions, relocation payments to lower income renters, ten percent inclusionary requirement with In-Lieu fee option, conformance with building code requirements at time of construction and with state building and noticing requirements and limited first-time homebuyer assistance from Housing Commission.

Analysis: This is the direction given by Council in February 2004. This policy encourages conversions and increased home ownership and provides some protections for lower income renters displaced by condominium conversions. San Diego's home ownership rate of 50-55 percent is much lower than the national average of 65-70 percent and conversions will help raise that level.

However, the pace of conversions has escalated rapidly in the past year so Council may want to revise this policy. Renter's rights advocates believe current policy does not adequately protect the low and moderate rental stock and lower income renters.

2. Limit Conversions

- a. **Numerical limitation-** Impose a numerical limit on number of units for which condo conversion maps will be issued. For example conversions in a given year could be limited to the number of new rental apartments built in a given year (La Mesa has done this).

Analysis: This could end the rush to convert large numbers of units in the short term and result in preserving relatively affordable rental stock. Since apartment construction is not currently economical in most parts of San Diego and because very few new rental apartments are being constructed, this would eliminate most conversions. This would also eliminate the remaining primary source of relatively affordable for sale housing and reduce first time home buying opportunities. Apartment owners might decide to upgrade rentals into expensive high-end rentals; since they could no longer convert them which would still reduce the supply of relatively affordable units.

- b. **Tie to vacancy rate and rental rate increase-** This option would allow condo conversion maps to be processed only in years when the vacancy rate is below a certain percentage and when the average rental rate increase is below a certain percentage.

Analysis: This would allow the benefits of condo conversions for homeowners, but only during times when the impacts on the rental market are deemed to be manageable. During the periods when conversions are not permitted, the same limitations on homeownership opportunities identified for Alternative 1a would be in effect.

- c. **Temporary moratorium-** Impose a temporary moratorium on condo conversion maps for a specified period of time to allow time to assess impacts of conversions.

Analysis: This would allow time to better understand the impacts of condo conversions, discuss more permanent solutions to the issue, and at least temporarily limit the rapid loss of relatively affordable rental units. However, this would limit affordable and first time homebuyer opportunities and could create a procedural problem in determining who is grandfathered and who is not. The extra time for some projects to convert could increase the price of the condo units ultimately offered for sale.

The City Attorney has advised that a four fifths vote determining that the current rate of condominium conversions and its impacts constitute a current and immediate threat to public health and safety would need to be made by City Council prior to enacting such an interim measure. This could be difficult at the present time because rental rates and vacancy rates have been fairly stable during the past year.

- d. **Permanent ban-** Enact a permanent ban on condominium conversions

Analysis: This major intervention in the housing market would provide permanent protection for affordable rental stock and lower income renters. However, homeownership would be discouraged by limiting affordable for sale units. Another likely impact would be reduced upgrading of housing stock. This option would significantly limit property owner rights.

3. Increase Regulatory Requirements

- a. **Require Certificates of Compliance-** Require that all projects proposing to convert in San Diego, including the “off-the-shelf” conversions, be required to obtain a Certificate of Compliance or Condominium Conversion Permit.

Analysis: If this policy were implemented, the City would have the ability to track the number of conversions occurring. In addition, the relocation payments required of other conversions could possibly be imposed on the “off-the-shelf” conversions, thereby assisting many lower income renters who are not currently receiving assistance. However, the policy may be difficult to enforce because the State does not require converters who already have a condominium map, to obtain additional permits or certificates from cities. Administrative costs and workloads would increase if the City begins to regulate “off-the-shelf” condominiums.

- b. **Adherence to current code requirements-** Require conversions to meet current building and parking standards.

Analysis: This would result in upgrading properties that do not meet current parking and building standards. This could significantly reduce or eliminate the current rush to convert many smaller and older properties that do not meet existing standards. Another argument some have offered is that when apartments are converted they often become more upscale in the process and that the new owners will have more cars than the renters thus requiring more parking.

It may not be advisable during a severe housing affordability crisis to require buildings that were legally constructed and are in satisfactory condition to be upgraded to current standards. This would increase the cost of these units and potentially worsen the affordability crisis. This would also introduce to San Diego, for the first time, a City policy that for-sale units should meet higher quality standards than rental units. This could perpetuate stereotypes of rentals as being less desirable forms of housing and of renters as being less desirable than owners. Since this requirement would make most conversions more difficult and expensive to accomplish, the likely result is that there would be far fewer conversions but those that do take place will become significantly more expensive. Prices would likely be more similar to those in new condominiums which are typically 50-100 percent higher than those at recently converted projects.

- c. Increased code requirements-** Impose increased building code and parking requirements for conversions, but not to current standards.

Analysis: This is a policy, with many variations, that many other cities have adopted. It would help ensure that units that are far below current building and parking standards be upgraded to some higher level prior to conversion. It would likely slow conversions of the smallest oldest rental units in older neighborhoods but would not be nearly as restrictive as a policy requiring all converted units to meet current standards. As with Alternative 2b, this would create a two-tier system where for-sale units would have to meet higher standards than existing and rehabilitated rentals. It may be difficult to decide precisely what standards these conversion units should meet.

4. Increase Ownership and Affordability Requirements

- a. On-site rental requirement-** Require that a portion of the units in larger complexes that are being converted remain as rentals. There are many variations that could be considered under this option. The requirement could be permanent or there could be a time period after which the remainder of units could be converted or a phased conversion schedule could be established that allows a certain number of units to be converted per year.

Analysis: This would allow expansion of first-time and relatively affordable homeownership opportunities while protecting some of the rental stock for a period of time, providing housing for tenants who do not desire to purchase and who wish not to move. This might also reduce the current rush to convert large numbers of units in a very short time period.

This requirement could prove logistically difficult and impractical for some properties. It would increase the overall cost of some conversions which could result in higher prices for the condo units following conversion. This option would present administrative challenges in determining tenant interest and eligibility.

- b. On-site Inclusionary requirement-** Require that a portion of all converted units be restricted to be affordable (i.e., meet City's Inclusionary requirements on-site - not allowing In-Lieu fee payment option.)

Analysis: This would ensure that some of the units remain relatively affordable and do not shift quickly to higher income portions of the market. It would be easier and more practical than requiring developers of new housing to provide affordable units on site. Justification for this policy, which is different from the Inclusionary requirement for new construction, is that, unlike new construction, conversions involve existing dwellings and displace existing residents from their homes.

This option would not directly address the loss of rental stock. It would be much easier for lower cost units to comply with this requirement than for projects with large expensive units or projects in very expensive locations because the Inclusionary ordinance allows the option of providing for-sale units priced at 100 percent or less of AMI.

5. Expand Tenants Rights

- a. Expand Relocation Requirement-** Expand the required relocation payments to cover all displaced renters who choose not to purchase their unit regardless of income. Require payment of three months rent for families earning less than 100 percent of AMI, two-months payment for families earning 100-150 percent of AMI and one-month's payment for families earning 150 percent or more of AMI.

Analysis: This would provide some protection for elderly, students and other renters who are not low income but are not in a position to or do not choose to buy their unit but who will be faced with relocation costs, time and discomfort associated with involuntarily moving. This would increase the costs to the Housing Commission of administering the relocation program by expanding the scope and complexity of that program and would not be likely to impact the rate of condominium conversions and the commensurate loss of rental housing.

- b. Simplify Relocation Requirement-** Provide three-months-rent relocation for all tenants displaced by conversion, regardless of income.

Analysis: This would benefit elderly, students and other non low-income renters. Simplified collection system would significantly decrease the costs, time and complexity for the Housing Commission to administer this program.

This option would be unlikely to significantly impact the rate of condominium conversions and the commensurate loss of rental housing. It would provide payments to some people who may not need them and would increase conversion costs somewhat.

- c. Expand Initial Notice Requirements-** Require the initial notice to tenants to include a description of all tenant rights and future notices.

Analysis: Tenants would have an explanation and better understanding of the entire process at the beginning of the process. However, this may be difficult in some instances because the sequence of events cannot always be determined at the time of the initial notice.

Respectfully submitted,

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ATTACHMENTS:

1. Applications for Condominium maps, 1999 to Jan 2004
2. Applications for Condominium maps, 2004 Feb to present
3. Comparison chart of conversion provisions in California cities
4. Condominium Conversion process diagram
5. Summary of Condominium Conversion Notice requirements